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No. 86-668

# In the Supreme Court

OF THE

# United States

OCTOBER TERM, 1986

MERRILL LYNCH, PIERCE, FENNER & SMITH INC.,
*Petitioner,*

v.

DAVID DELMAN,
*Respondent.*

## OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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OCTOBER TERM, 1986

MERRILL LYNCH, PIERCE, FENNER & SMITH INC.,
*Petitioner,*

v.

DAVID DELMAN,
*Respondent.*

## OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Respondent, David Delman ("Delman"), respectfully prays that Merrill Lynch, Pierce, Fenner & Smith Inc.'s ("Merrill Lynch") Petition for Writ of Certiorari to review the decision of the United States Court of Appeals for the Ninth Circuit in this case be denied.

## STATUTORY PROVISIONS

The following statutory provisions are also relevant to this case:

1. Securities Exchange Act of 1934, Section 29(a), 15 U.S.C. § 78cc(a).

2. Securities Exchange Act of 1934, Section 27, 15 U.S.C. § 78aa.

The Appendix to this response sets forth the pertinent text of the statutory provisions. (1a)[1].

## STATEMENT OF THE CASE

In addition to the factual and procedural background set forth in Merrill Lynch's petition, the following procedural history is significant.

On July 25, 1985 the United States District Court, Central District of California, entered its Amended Memorandum and Order (the "Order") ordering Delman's pendent state claims to arbitration and retaining jurisdiction of Delman's federal securities claims under the Securities Exchange Act of 1934, as amended (the "1934 Act"). (Petition, 3a).[2] Thereafter, Delman filed a Motion for Reconsideration of the Order requesting the district court to amend the Order to include a factual finding that Delman lacked the mental capacity to enter into the Customer and Option Agreements with Merrill Lynch. (Petition, 16a and 24a, respectively.) The district court denied Delman's motion but specifically stated that the issue of Delman's mental capacity to enter into the agreements was still an open issue to be decided by the district court. The Reporters Transcript of Proceedings is reprinted in the Appendix at 3a. As discussed *infra*, if the district court determines that Delman was not mentally competent at the time he signed the Merrill Lynch agreements, then the agreements are revocable and the issue presented in Merrill Lynch's petition shall become moot.

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[1]Citations to material printed in the attached appendix appear as "____a."

[2]Citations to material printed in the Appendix annexed to Merrill Lynch's petition appear as "Petition, ____a."

Delman filed a third amended complaint in the district court in May 1986 pursuant to the district court's order granting Delman leave to file the amended pleading. The amended complaint contains claims under the Racketeering Influenced Corrupt Organizations Act, 18 U.S.C. §§ 1962(b), 1962(c) and 1964(c) and a claim for rescission. Merrill Lynch answered the amended complaint and did not file a motion with the district court to compel arbitration of those claims.

## SUMMARY OF ARGUMENT

1. The issue presented in Merrill Lynch's petition is not ripe for consideration in this case. The federal district court has left upon for future consideration the issue of whether Delman was mentally competent to enter into the Merrill Lynch Customer and Option Agreements. Under applicable California state law, a contract is revocable if a person was not mentally competent to deal with the subject matter of the contract with a full understanding of his rights. Delman contends that medical evidence available at the time he signed the Customer and Option Agreements demonstrates his lack of mental capacity to enter into a binding and enforceable contract. Therefore, if the district court, upon deciding the issue of Delman's mental capacity, concludes Delman was incompetent to enter into the Merrill Lynch agreements, then Merrill Lynch's petition will become moot.

2. The Ninth Circuit decisions in *Conover v. Dean Witter Reynolds, Inc.*, 794 F.2d 520 (9th Cir. 1986) and in this case are not in conflict with any decision rendered by this Court. Congressional intent deducible from the text of the 1934 Act and its legislative history demonstrates that the implied right of action under Section 10(b), and

Rule 10b-5 promulgated thereunder, is not subject to predetermined arbitration by contract.

## REASONS FOR DENYING THE WRIT

### I

### MERRILL LYNCH'S PETITION FOR WRIT OF CERTIORARI IS NOT RIPE.

This Court can deny a Petition for Writ of Certiorari where the case is not yet ripe for review. *See, e.g., Brotherhood of Loc. Fire Eng. v. Bangor & A.R. Co.*, 389 U.S. 327, 88 S.Ct. 437, 19 L.Ed.2d 560 (1967). In the instant case, the district court has stated that a substantial issue remains open — did Delman have the mental competency to enter into the Customer and Option Agreements with Merrill Lynch. (3a).

If the district court determines that Delman lacked sufficient mental capacity to enter into the Merrill Lynch agreements, then it must rule under California law that the agreements are revocable. *Burgess v. Security-First Nat. Bank of Los Angeles*, 44 Cal. App. 2d 808, 113 P.2d 298 (1941); California Civil Code, §39. Such a determination by the district court would render Merrill Lynch's petition moot since the Customer and Option Agreements contain the arbitration clauses which are at issue.[3]

This case is not ripe for review because the critical issue regarding Delman's capacity to contract remains

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[3]The United States Arbitration Act provides that a provision in a written contract to settle a controversy by arbitration is invalid and revocable "upon such grounds as exist at law or in equity for the revocation of any contract." Arbitration Act, 9 U.S.C. §2. The district court ruled in the Order that "state law determines the enforceability of a particular agreement." (Petition, 8a.)

open for determination by the district court in a future proceeding (14a). The district court should be allowed to try the competency issue first before this Court proceeds with a review of the issue presented in Merrill Lynch's petition because such a review may be unnecessary for a final disposition of this case.

## II

## THE COURT OF APPEALS DECISION IS NOT IN CONFLICT WITH ANY DECISION RENDERED BY THIS COURT.

The decisions reached by the Ninth Circuit in this case and in *Conover v. Dean Witter Reynolds, Inc.*, 794 F.2d 520 (9th Cir. 1986) are not in conflict with any decision rendered by this Court, including *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. ____, 105 S.Ct. 3346, 87 L.Ed.2d 444 (1985). Decisions by the other circuits holding that claims arising under Section 10(b) of the Securities Exchange Act of 1934, as amended, 15 U.S.C. §78j(b) (the "1934 Act"), and Rule 10b-5 of the Securities and Exchange Commission, 17 C.F.R. § 240.10b-5, are not subject to arbitration under the United States Arbitration Act, Ch. 392, 61 Stat. 670 (1947) (Codified at 9 U.S.C. §1 *et seq.*) (the "Arbitration Act") are also not in conflict. In fact, both *Mitsubishi* and *Scherk v. Alberto-Culver Company*, 417 U.S. 506, 94 S.Ct. 2449, 41 L.Ed.2d 270 (1974) implicitly support the decision rendered by the Ninth Circuit in *Conover* and the instant case.

It is unquestioned that at issue in this case is the conflict between the statutory dictates and policies of the Arbitration Act and the 1934 Act. The Arbitration Act provides that a valid contract containing a provision to arbitrate a controversy arising out of the contract shall be

enforced except "upon such grounds as exist at law or equity for the revocation of any contract." Arbitration Act, 9 U.S.C. §2. Conversely, §29(a) of the 1934 Act mandates that any agreement binding a person to waive the right to a judicial forum is void. *Mitsubishi* expressly recognized that the dictates of the Arbitration Act would directly conflict with the dictates of other federal statutes, such as the 1934 Act. This Court concluded in *Mitsubishi* that "not ... all controversies implicating statutory rights are suitable for arbitration." 473 U.S. at ____, 105 S.Ct. at 3355. To resolve apparent statutory conflicts, this Court held that:

> "[I]t is the *congressional intention expressed in some other statute* on which the courts must rely to identify any category of claims as to which agreements to arbitrate will be held unenforceable."

*Id.* at ____, 105 S.Ct. at 3355 (emphasis added). (Citations omitted.)

Congressional intent "will be deducible from text or legislative history." *Id.* Thus, if the statutory language of the 1934 Act or the legislative history supporting the 1934 Act and its amendments evidences a congressional intent that the private right of action under section 10(b) be tried in a judicial forum, then such claims are not subject to predetermined agreements to arbitrate. Therefore, the specific issue before this Court is whether the congressional intent deducible from the language of 1934 Act or legislative history prohibits arbitration of claims arising under section 10(b) of the 1934 Act.

The Ninth Circuit, contrary to Merrill Lynch's contention that its analysis was "both erroneous and unneces-

sary" (Petition, page 10), expressly followed the analysis dictated by *Mitsubishi*:

> "To determine Congress' intent, we study the text, and both the legislative and judicial history of the 1934 Act, with due regard for the purposes underlying the securities and arbitration statutes."

*Conover*, 794 F.2d at 523.

### A. The Statutory Text of the 1934 Act Evidences Congress' Intent That Implied Rights Of Action Under Section 10(b) Are Not to be Arbitrated

In *Wilko v. Swan*, 346 U.S. 427, 74 S.Ct. 182, 98 L.Ed. 168 (1953), this Court first recognized and addressed the tension between the respective policies of the Arbitration Act and the Securities Act of 1933, as amended (the "1933 Act"). *Wilko* involved a claim under section 12(2) of the 1933 Act, 15 U.S.C. § 771(2), which creates a right of recovery for misrepresentation in the sale of securities. The parties had entered into margin agreements containing a provision that any controversies arising between them in the future would be arbitrated. This Court held that such an agreement was void under the non-waiver provision contained in section 14 of the 1933 Act, which provides:

> "Any condition, *stipulation* or provision binding any person acquiring any security *to waive* compliance with any provision of this subchapter or the rules and regulations of the Commission *shall be void*."

15 U.S.C. § 77n (emphasis added).

In reaching its result, this Court concluded that an agreement to arbitrate was a "stipulation" and the right to a judicial forum granted under section 22(a) of the 1933 Act, 15 U.S.C. § 77v(a), for any violation of such act,

was a "provision" that could not be waived under § 14 of the 1933 Act even in light of the language and policies of the Arbitration Act. *Wilko*, 346 U.S. at 434-35, 74. S.Ct. at 186.

The 1934 Act contains a non-waiver provision virtually identical to section 14 of the 1933 Act. Section 29(a) of the 1934 Act provides:

> "Any condition, *stipulation* or provision binding any person *to waive* compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby *shall be void.*"

15 U.S.C. § 78cc(a) (emphasis added).

Likewise, section 27 of the 1934 Act, 15 U.S.C. § 78aa, is virtually identical to section 22(a) of the 1933 Act in granting a right to a judicial forum for violation of "provisions" of the 1934 Act.[4]

Even though the non-waiver provisions of the 1933 Act and 1934 Act are essentially identical, Merrill Lynch contends that a 10(b) claim under the 1934 Act is not entitled to the same protection of a non-waivable judicial forum as a 12(2) claim under the 1933 Act because the former is a judicially implied right while the latter is an expressly stated right. Such a contention is without merit.

*Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946) was the first case to recognize an implied right of action under section 10(b). *Kardon* is instructive on fully understanding the status of the law in the period in which the 1934 Act was written and thus sheds light on

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[4]The 1934 Act provides, (i) greater venue choices than does the 1933 Act, and (ii) exclusive jurisdiction in the federal court while the 1933 Act grants concurrent jurisdiction to federal and state courts.

the meaning of the actual text of section 10(b). Utilizing this Court's opinion in *Texas & Pacific R. Co. v. Rigsby* for concluding that Congress intended a private right of action for section 10(b) violations, the *Kardon* court held:

> "It is also true that there is no provision in Sec. 10 or elsewhere expressly allowing civil suits by persons injured as a result of violation of Sec. 10 or the Rule. However, 'the violation of a legislative enactment by doing a prohibited act, or by failing to do a required act, makes the action liable for an invasion of an interest of another if; (a) *the intent of the enactment* is exclusively or in part to protect an interest of the other as an individual; and (b) the interest invaded is one which the enactment is *intended to protect.* ***Restatement, Torts, Vol. 2, Sec. 286. This rule is more than merely a canon of statutory interpretation. The disregard of the command of a statute is a wrongful act and a tort. As was said in *Texas & Pacific R. Co. v. Rigsby,* 241 U.S. 33, 39, 36 S.Ct. 482, 484, 60 L.Ed. 874, 'This is but an application of the maxim, Ubi jus ibi remedium.'"

*Kardon,* 69 F.Supp. at 513 (emphasis added).

The *Kardon* court concluded that 10(b) set forth a fundamental right of statutory protection mandated by the "general law" at that time and to withhold such a private right of action would have required Congress to have stated expressly its intention to withhold a right of action; such language should have appeared "very clearly and plainly." *Id.* at 514. Since Congress did not withhold a right of action in "clear and plain" language, the *Kardon* court concluded that the text of the statute itself evidenced Congress' intent to allow a private right of action under 10(b). "[T]he mere omission of an express provision for civil liability is not sufficient to negative

what the general law implies." *Id.* In *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Curran,* 456 U.S. 353, 378, 102 S.Ct. 1825, 1839, 72 L.Ed.2d 182 (1982), this Court expressly adopted the type of inquiry engaged in by the *Kardon* court in a different context:

> "In determining whether a private cause of action is implicit in a federal statutory scheme when the statute by its terms is silent on that issue, *the initial focus must be on the state of the law at the time the legislation was enacted.*" (emphasis added).

*See, Cannon v. University of Chicago,* 441 U.S. 677, 99 S.Ct. 1946, 60 L.Ed.2d 560 (1979).

In *Superintendent of Ins. of St. of N.Y. v. Bankers L.&C. Co.,* 404 U.S. 6, 92 S.Ct. 165, 30 L.Ed.2d 128 (1971), this Court first acknowledged that a private claim could be asserted on the basis of violations of Rule 10b-5. By endorsing a private remedy under section 10(b), this Court implicitly recognized the *Kardon* decision, and its express finding that the statutory language itself evidenced Congress' intent to grant a private action under section 10(b). *Id.* at 12, 92 S.Ct. at 169.

More recently, this Court in a unanimous decision reaffirmed its recognition of a private right of action under 10(b) and Rule 10b-5 and held that, "the existence of this implied remedy is simply beyond preadventure." *Herman & MacLean v. Huddleston,* 459 U.S. 375, 380, 103 S.Ct. 683, 686, 74 L.Ed.2d 548 (1983). *Herman & MacLean* is particularly instructive given this Court's holdings in *Cort v. Ash,* 422 U.S. 66, 95 S.Ct. 2080, 45 L.Ed.2d 26 (1975) and *Merrill Lynch, Pierce, Fenner & Smith v. Curran. Cort v. Ash* established the criteria for determining the availability of implied private actions. Critical to that determination is a finding of either ex-

plicit or implicit legislative intent to create or deny such a remedy. *Cort,* 422 U.S. at 78, 95 S.Ct. at 2088. *Curran* further clarified the approach for determining implied actions by stating that the Court's focus "must be on the 'intent of Congress'." *Curran,* 456 U.S. at 377, 102 S.Ct. at 1839. *MacLean & Huddleston's* affirmation of the existence of a private right of action under section 10(b), after the decisions in *Cort v. Ash* and *Curran,* establish that this Court has already found that Congress intended a private remedy under section 10(b). [5]

## B. The Legislative History of the 1934 Act Evidences Congress' Intent That Implied Rights of Action Under Section 10(b) Are Not to Be Arbitrated

On June 4, 1975, Congress adopted the Securities Acts Amendments of 1975. Pub. L. 94-29, 89 Stat. 97. These amendments were the "most substantial and significant revision of this country's Federal securities laws since the passage of the Securities Exchange Act of 1934." *Herman & MacLean,* 459 U.S. at 384, 103 S.Ct. at 688, quoting Hearings on S. 249 before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs, 94th Cong., 1st Sess., 1 (1975). At the time of these amendments, the existence of a private cause of action under section 10(b) and Rule 10b-5 had been recognized by 10 of the 11 Courts of Appeals. *Id.* at 380, n.10, 103 S.Ct. at 686, n.10.

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[5]Merrill Lynch's contention that this Court's opinion in *Scherk v. Alberto-Culver Co.,* 417 U.S. 506, 94 S.Ct. 2449, 41 L.Ed.2d 270 (1974) holds otherwise is without merit. *Scherk* was expressly limited to situations involving international comity. This Court stated:

> "Concededly, situations may arise where the contacts with foreign countries are so insignificant or attenuated that the holding in *Wilko* would meaningfully apply."

*Id* at 517, n.11, 94 S.Ct. at 2456, n.11.

Justice Stevens, writing for a majority of the Court in *Curran,* held that implied claims under the Commodity Exchange Act, 7 U.S.C. 1 *et seq.* (the "Commodity Act"), were routinely recognized by the lower courts in 1974 when Congress extensively amended that act. This Court concluded that Congress' re-enactment of the Commodity Act in light of judicial decisions implying a private remedy demonstrated that Congress intended to preserve such a remedy. *Curran,* 456 U.S. at 381-82, 102 S.Ct. at 1841.

Likewise, the 1975 amendments to the 1934 Act left section 10(b) intact in light of numerous judicial decisions over approximately 40 years, including this Court's decision in *Superintendent of Ins. of St. of N.Y. v. Bankers L.&C. Co.,* holding a private right of action exists under section 10(b). Congress' "re-enactment" of the 1934 Act, in light of the "contemporary legal context", demonstrates that Congress ratified the implied private right of action under section 10(b) as a part of the 1934 Act. *Herman & MacLean,* 459 U.S. at 385-86, 103 S.Ct. at 689.

The House Conference Report on the 1975 Amendments also affirms that Congress intended section 10(b) and Rule 10b-5 to provide a private remedy. In a discussion of its amendment to section 28 of the 1934 Act, the House Conference Report emphasized Congress' intent that arbitration agreements would not be permitted between brokers and customers for violations of the 1934 Act:

> "It was the *clear understanding* of the conferees that this amendment did not change existing law, as articulated in *Wilko v. Swan* . . . concerning the effect of arbitration proceeding provisions in agreements entered into by persons dealing with members and participants of self-regulatory organizations."

H.R. Rep. No. 229, 94th Cong., 1st Sess. 111, *reprinted in* 1975 U.S. Code Cong. & Ad. News 342. (emphasis added). The legislative history of the 1934 Act provides a compelling account of Congress' intent that the doctrine of *Wilko v. Swan* apply in the 10b-5 context.

### C. Policies Underlying the Federal Securities Laws Mandate A Judicial Forum For Section 10(b) Claims.

Congress' intent that private claims under section 10(b) and Rule 10b-5 of the 1934 Act not be subject to arbitration between a customer and broker is clear from the text of the statute itself and the legislative history. Merrill Lynch's contention that inconsistency in decisions exists over the issue of arbitrability of section 10(b) claims is without support upon review of this Court's prior decisions as outlined *supra.* Further, the policies supporting the 1934 Act, and the protections granted to parties for violations thereof, would be significantly diminished without a judicial forum for section 10(b) claims.

The fundamental purpose of the 10b-5 remedy is to protect vulnerable purchasers of securities from the aggressive and more sophisticated buyer or seller. *Wilko v. Swan* recognized this inherent policy in holding that such protective aspect outweighed any policy interest in quick resolution of disputes through arbitration. This Court has emphasized that "the '33 and '34 Acts constitute interrelated components of the federal regulatory scheme governing transactions in securities." *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 206, 96 S.Ct. 1375, 1387, 47 L.Ed.2d 668 (1976).

In *Herman & MacLean,* this Court held that Congress' decision to leave section 10(b) intact with a private

remedy for violations thereof furthered the "broad remedial purposes" of the securities laws. 459 U.S. at 386, 103 S.Ct. at 689. "Rule 10b-5 is, after all, the most important remedy in both Acts." *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Morre,* 590 F.2d 823, 829 (10th Cir. 1978). The broad remedial purposes of the securities laws cannot be enforced if private actions are forced into arbitration.

The purpose of section 29(a) of the 1934 Act is to prevent the waiver of a right to a judicial forum because of the startling and unquestioned fundamental differences between litigation in a federal court and arbitration:

> (1) 10b-5 requires a subjective finding on the "purpose and knowledge of an alleged violator." *Conover,* 749 F.2d at 526. This Court held in *Wilko v. Swan* that such questions are ill-determined by arbitrators without judicial instruction on the law. *Wilko v. Swan,* 346 U.S. at 435, 74 S.Ct. at 187; *Scherk v. Alberto-Culver Company,* 417 U.S. at 532, 94 S.Ct. at 2463.
>
> (2) An arbitration award can be made "without explication of reasons and without development of a record so that an arbitrator's" concept of this Court's statutory requirements may be fundamentally incorrect, "yet functionally unreviewable," because there is no judicial review corresponding to review of court decisions. *Id.*
>
> (3) Extensive pretrial discovery provided by the Federal Rules of Civil Procedure would not be available. *Scherk v. Alberto-Culver Company,* 417 U.S. at 532, 94 S.Ct. at 2463. This right is particularly significant in securities cases where most of the

relevant documentation to support a 10b-5 claim is held by the brokerage firm.

(4) The wide choice of venue provided by 15 U.S.C. § 78aa of the 1934 Act would be forfeited. *Id.*

Therefore, the loss of a judicial forum carries with it the loss of substantial rights. This Court has previously held that a waiver of a judicial trial and review is simply inconsistent with Congress' overriding concern for the protection of investors. *Wilko v. Swan*, 346 U.S. 427, 74 S.Ct. 182 (1953). The non-waiver provision of § 29(a) was designed to prohibit a party of greater strength from causing an unsophisticated individual to waive the same substantial rights present in *Wilko v. Swan*. All of these factors, in light of Congress' intent as evidenced by the statutory text of the 1934 Act and its legislative history, demonstrate that Congress intended to preclude enforcement of predispute agreements requiring arbitration of a section 10(b) claim.

## CONCLUSION

A review of the issue in the instant case by this Court is premature as the issue is not ripe. This Court's prior decisions, including the recent unanimous decision in *Herman & MacLean v. Huddleston*, clearly evidence that section 10(b) claims are not subject to predispute agreements to arbitrate. The Ninth Circuit decisions in *Conover v. Dean Witter Reynolds, Inc.* and this case are not in conflict with any decision rendered by this Court. Delman respectfully requests that Merrill Lynch's Petition for

Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit be denied.

January 7, 1987

Respectfully submitted,

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# APPENDIX

## STATUTORY PROVISIONS

Securities Exchange Act of 1984, Section 29(a), 15 U.S.C. § 78cc(a):

> "(a) Any condition, stipulation or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void."

Securities Exchange Act of 1984, Section 27, 15 U.S.C. § 78aa:

> "The district courts of the United States, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, or to enjoin any violation of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291

and 1292 of Title 28. No costs shall be assessed for or against the Commission in any proceeding under this chapter brought by or against it in the Supreme Court or such other courts."

No. CV 84-3869-MRP

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

HONORABLE MARIANA R. PFAELZER, JUDGE PRESIDING

DAVID DELMAN,
*Plaintiff,*

vs.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.,
*Defendant.*

**REPORTER'S TRANSCRIPT OF PROCEEDINGS**

Los Angeles, California
Monday, September 30, 1985

APPEARANCES:

For the Plaintiff:

KINSELLA, BOESCH, FUJIKAWA & TOWLE
By: DALE F. KINSELLA
1875 Century Park East, 16th Floor
Los Angeles, California 90067-2593

For the Defendant:

OVERTON, LYMAN & PRINCE
By: WILLIAM K. SWANK
555 South Flower Street
Los Angeles, California 90071

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LOS ANGELES, CALIFORNIA;
MONDAY, SEPTEMBER 30, 1985; 10:00 A.M.

THE CLERK: Item No. 5, Civil 84-3869, David Delman versus Merrill Lynch, Pierce, Fenner & Smith.

Counsel, please state your appearance.

MR. KINSELLA: Good morning, your Honor, Dale Kinsella.

MR. SWANK: William Swank on behalf of defendant Merrill Lynch.

THE COURT: Well, Mr. Kinsella, why did it take so long?

MR. KINSELLA: I came prepared to speak about jurisdiction, your Honor.

THE COURT: All right. You go ahead and speak about it.

MR. KINSELLA: I am only being partially facetious. I don't believe there is a serious question regarding jurisdiction. If your Honor does, I am prepared to address it.

THE COURT: There is a very serious problem about jurisdiction.

MR. KINSELLA: I had a suspicion that your Honor was of that state of mind. Can I spend two minutes clarifying the situation because I am convinced there certainly is jurisdiction in this case.

First, if you will take a look at the Bird opinion, the very first paragraph of the Bird opinion clarifies why the Supreme Court had jurisdiction in that case under 1292(a)(1) which is not applicable here.

As you may recall in Bird what Merrill Lynch did there was they moved to sever the state claims and they moved to stay the state claims and proceed on the federal claims. Judge Turrentine denied that motion.

Merrill Lynch appealed from that portion of Judge Turrentine's order staying the state claims so it was as appeal from the stay order of Judge Turrentine's decision.

What the Supreme court held was they had jurisdiction under 1292(a)(1) because that was tantamount to an injunction. What has Merrill Lynch appealed from with respect to your order?

If you will just bear with me, I think I can walk us through this as to why there is jurisdiction in this case.

In your order which I am reading from you make five separate orders. No. 2 is that you order that defendants' motion for an order compelling arbitration of the federal securities law claim is denied.

No. 3, defendants' motion for an order staying the federal court proceedings is denied.

Now if Merrill Lynch has appealed from both of these, I am going to take my place. However, I think if you will take a look at the notice of appeal, it clarifies beyond any doubt that portion of the order they have appealed from. It specifically states in the notice of appeal:

> "Merrill Lynch hereby appeals to the United States District Court, et cetera, from that portion of this Court's order on the 27th day of June, 1985 which denies the petition for order compelling arbitration of plaintiff's claims under the Securities and Exchange Act of 1934."

THE COURT: I know.

MR. KINSELLA: They do not appeal the stay order. Now the only reason that this Court conceivably could be divested of jurisdiction would be if under 1292(a)(1) there was an improper appeal and there is no appeal from the stay aspect of this case.

We have referred, your Honor, in a very late reply — but it was in response to a late opposition, to the Sealy Mattress case which holds that a denial of an order of arbitration of a claim is not appealable under 1292(a)(1) and I think — and I don't mean this disrespectfully toward Mr. Swank — there appears to be a suggestion that perhaps this was an appeal from your Honor's order denying the stay which it is not.

The notice of appeal — indeed their own moving papers here clarify the issue, so I think we are over the hurdle of jurisdiction. Indeed we have been before your Honor for the last two months talking about trial dates. This is the first time anybody has suggested that your Honor didn't have authority to set trial dates or conduct discovery or resolve discovery disputes in this matter so I think there is clearly jurisdiction with respect to this matter.

With respect to the issue of delay, there have been several factors here at play. First, we attempted to conduct an exhaustive review of the medical evidence in this case that was before your Honor to determine whether or not your Honor had considered everything that was in front of her.

Frankly, it was not until about a month and a half ago that we realized that the most critical portions of Dr. Cope's medical records that we wanted your Honor to review had in fact been blacked out. We did take a red liner and attempted to go over those portions of the medical evidence which we wanted your Honor to review

and we accomplished just the opposite. It was struck from the record. That was not discovered until we were here on another matter before your Honor.

In addition, there have been other factors which I am prepared to go into with respect to why we were slightly late in this. Your Honor may recall that it was about a month and a half ago when I requested of your Honor to file this motion for reconsideration.

I recognize your Honor didn't rule on the merits but you invited it. What I am suggesting is there is not a four-month delay here. At best there is a month-and-a-half to a two-month delay and that was in large part the result of our recent discovery that we had in fact obliterated the very portion of the record we wanted your Honor to review.

If your Honor believes there is jurisdiction, which I hope, and that I have not been dilatory in this, and I have tried my level best to get this matter back before your Honor, I would like to spend a few minutes talking about the merits of why we are here.

On the other hand, there is a full calendar.

THE COURT: We have gotten to the place now where a person on the staff of the Ninth Circuit is going to have a difficult time figuring out what we all have been doing.

Let us see if we can review everything now. We are in a position where I have entered an order that the state law claims must be arbitrated. In that order there was language that said that your client could read the agreement and understand what it said and as long as he could read the agreement and understand what it said he is bound to arbitrate it.

They said if that is true of the state law claims that the Court has ordered arbitrated, it must also be true of the federal securities claims.

I said, "No, I would not order arbitration of the federal securities claims" because I didn't think that was right, assuming, of course, that the arbitration clause bound him to everything that he could possibly be bound to.

Now they say, "Will you certify it?"

And I said, "Yes," smiling because I wanted to see what the Ninth Circuit would say and I still do. I read the paper every day hoping I will find that case decided.

Now they are up on the question of whether the federal claims have to be arbitrated as well as the state law claims. You are in on a reconsideration of the order which I entered ordering the state law claims to be arbitrated and also ordering that there be no stay of that; is that right?

MR. KINSELLA: May I complicate it just a little bit more?

THE COURT: It is probably worse than that.

MR. KINSELLA: Believe it or not, it is. There are essentially two appeals. What Mr. Swank —

THE COURT: You have got one, too?

MR. KINSELLA: Mr. Swank has appealed on two grounds. He has taken a 1292(b) appeal.

THE COURT: Yes.

MR. KINSELLA: He is suggesting that this Court is divested of jurisdiction because of his 1292(a)(1) appeal.

THE COURT: You are right.

MR. KINSELLA: Yes. My first thought was not to file it.

THE COURT: In the 15 minutes you get in the Ninth Circuit somebody is going to get up and explain this?

MR. KINSELLA: I agree and we probably will not even get past "Good morning, your Honors."

THE COURT: Somebody is going to say, "What have you done?"

MR. KINSELLA: I know. Without sounding too self-serving, I am giving us an opportunity to resurrect this whole mess and get the background before your Honor but I know this is causing Mr. Swank great pain.

In point of fact, there is jurisdiction in front of the Court to hear what I am here for. I don't think there is any question about that.

I also think in light of what we did that there is a reasonable basis for reconsidering this, that is the delay.

What I am requesting of your Honor is this: If you believe there is jurisdiction for me to be here speaking and if I haven't been dilatory, I would like to spend — and I promise — no more than three minutes on the issue of the merits of why we are asking for reconsideration.

There is a full calendar, however, and if you think you do not have jurisdiction, I don't want to go forward. I do believe that that issue hopefully is quite clear and I would like to spend just a very brief period of time on the merits.

THE COURT: Let me hear Mr. Swank.

MR. SWANK: Your Honor, our brief is being filed in the Ninth Circuit today. If the Court reconsiders this issue and as the Court said holds for some reason that

Mr. Delman did not have the capacity to enter into a contract —

THE COURT: Well, I couldn't do that on what I have in front of me.

MR. SWANK: I am sorry, your Honor?

THE COURT: I couldn't do that.

MR. SWANK: No, your Honor. You don't have any evidence in front of you on Mr. Delman's condition.

THE COURT: I don't know whether he has the capacity or not. From what I looked at on the first go-around it appeared to me that there was no reason to hold that he didn't.

MR. SWANK: Yes. Your Honor, we are now in the posture in the Ninth Circuit of agreeing with the Court that it is an adhesion contract but there is no suggestion that Mr. Delman did not have the capacity to enter into it. If the Court reconsiders that now and changes our ruling then we will spend a lot of time on an appeal.

THE COURT: What position did you take with respect to adhesion?

MR. SWANK: Your Honor, I think we agree that the contract is an adhesion contract but as the Court ruled all adhesion contracts are not, therefore, unenforceable.

THE COURT: No, they are not.

MR. SWANK: Indeed the Merrill Lynch contract has been held by California courts to be enforceable and it so held in Parr. The adhesion contract or the contract the Court found was a fair contract because the procedures embodied in the contract were fair, the arbitration procedures.

There is no suggestion now before the Court that those procedures are anything but fair. There is no suggestion or reason to believe that Mr. Delman won't be treated fairly in arbitration or that his capacity to understand trades or not understand trades he made is going to be precluded in arbitration.

All those issues are going to be before the arbitrators in a process that this Court and California courts have found to be fair.

Mr. Delman, the plaintiff, and his attorneys, had a full opportunity to brief whatever special defenses they believe Mr. Delman has. I am not sure there are any special defenses to an arbitration agreement that the Courts finds to be fair, binding and insures fairness in the arbitration procedure.

However, I would not like to take that up on appeal at this late date. I would prefer finding in the record as it is, that Mr. Delman could read the contract had he bothered to do so. I think now to go back and reconsider that when we had that ruling and I think at least four months ago the Court's initial ruling on the bench and then it took a month to get the order entered — we have had that ruling for four months.

There has been no suggestion that that ruling was wrong or that the Court didn't have the evidence Mr. Kinsella wanted before it at that time. I think to go back now and reconsider it —

THE COURT: If you win on appeal where are we then?

MR. SWANK: We are —

THE COURT: You may well think of that.

MR. SWANK: We are arbitrating all of Mr. Delman's claims except his RICO claims which the Court allowed him to amend which I suppose we will try.

THE COURT: So we would come back down here.

Would he be foreclosed at that point to say that it hadn't been properly before the Court, that he didn't understand it, he wouldn't have been able to understand, wouldn't have had the capacity.

That is not foreclosed, is it, because that is not an issue on appeal?

MR. SWANK: I am not sure that it is an issue on appeal, your Honor. I believe it is involved in the appeal which is the test in the present instance. It certainly is involved in the appeal to the extent if the Court reverses its finding or holds an additional hearing there won't be an appeal in its present posture.

I suppose if it came back from the Ninth Circuit on the arbitration it would probably get before the Court again, certainly at the point where the Court is asked to confirm the arbitrator's award.

I suppose if at that point the Court felt that Mr. Delman had been treated unfairly in arbitration or that he was unable to agree to arbitrate, that you could then reconsider that issue.

I think that makes a lot of sense to do it that way, frankly, rather than moving the appeal at this stage.

THE COURT: This is just a passing comment. I understand. We have created for the Ninth Circuit a real problem here.

MR. SWANK: Yes, your Honor.

THE COURT: But it is not our problem any more on this level.

MR. SWANK: It is my problem.

THE COURT: I say good luck to them. Let me just tell you in passing that I don't think I ever made a finding as to his competency. I think I said that the record did not show that he was incompetent to do that.

MR. SWANK: Your Honor, I believe that you did say that there is no claim that Mr. Delman was unable to read and understand. That is my recollection.

THE COURT: Yes. The question is if there wasn't any claim at that point could there ever be a claim of that nature. I think I have to say this to you. I can't grant the motion for reconsideration because I actually don't believe I have the jurisdiction to do this now.

I can't open up this whole thing now but I don't say that it can't be opened up. I spent quite a long time yesterday thinking about that. I reread the order and I also considered whether Mr. Kinsella is right about being taken back at the statement that he could read and understand what that clause was if he wanted to so I will deny the motion to reconsider.

You will go up on appeal and then you will consider whether I am correct about what I said because I think that issue when you come back from appeal is open.

MR. KINSELLA: Thank you.

MR. SWANK: Thank you.

THE COURT: You prepare an order, Mr. Swank.

MR. SWANK: Your Honor, on a related matter, we came in and they made a motion to amend the RICO claim.

THE COURT: I am just denying the motion to reconsider and I am not doing it solely on the ground of jurisdiction.

When you do the order bear that in mind.

MR. SWANK: I understand this relates to the amendment of their complaint to add a RICO claim. We moved to — there is no entry of an order yet. We would like to pursue an appeal of that order as well.

THE COURT: We will see.

MR. SWANK: It was their motion to amend. We said, "amend," but we think it should be compelled to arbitration. They opposed it. The Court allowed them to amend the complaint and deny the order compelling arbitration.

THE COURT: There is no order.

MR. SWANK: There is no order.

THE COURT: You do an order.

MR. KINSELLA: Your Honor, in that regard there is also a pending motion for summary judgment.

THE COURT: Yes.

MR. KINSELLA: One final question. I am not sure I understood or want to frankly understand the full import of your Honor's ruling.

THE COURT: I denied the motion for reconsideration. That is what I wanted to put in the record.

MR. KINSELLA: On the basis of jurisdiction. Does that mean until the Ninth Circuit rules on the 1292(b) appeal?

THE COURT: I think that I no longer have jurisdiction to do anything about those orders.

MR. KINSELLA: The appeal orders?

THE COURT: Yes, those that have been appealed.

MR. SWANK: Yes, your Honor.

MR. KINSELLA: All right. Thank you, your honor.

THE COURT: I could point you to a case but I think that that will be pointed out to you anyway in the conference.

All right.

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I certify that the foregoing is a correct transcript from the record of proceedings in the above-entitled matter.

BETH E. AUBERTSON — Official Reporter

10-6-85 — Date

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## PROOF OF SERVICE BY MAIL

I am a citizen of the United States and a resident of the City and County of Los Angeles; I am over the age of eighteen years and not a party to the within action; my business address is: 1706 Maple Avenue, Los Angeles, California.

On January 7, 1987, I served the within Opposition to Petition for a Writ of Certiorari in re: "Merrill Lynch, Pierce, Fenner & Smith Inc. vs. David Delman" in the United States Supreme Court, October Term 1986, No. 86-668;

on the Parties in said action, by placing three copies thereof enclosed in a sealed envelope with postage fully prepaid, in the United States post office mail box at Los Angeles, California, addressed as follows:

Peter Brown Dolan
Overton, Lyman & Prince
550 So. Flower Street
6th Floor
Los Angeles, California 90071

All Parties required to be served have been served.

I certify (or declare), under penalty of perjury, that the foregoing is true and correct.

Executed on January 7, 1987, at Los Angeles, California

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CE CE MEDINA